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MICHAEL RODAK, JR.[illegible]

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1972

**No. 72-1740**

RICHARD J. SENNOTT AND JOAN SENNOTT,
*Petitioners,*

*vs.*

RODMAN & RENSHAW,
*Respondent.*

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

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Respondent, Rodman & Renshaw, respectfully submits that the Petition for Writ of Certiorari filed by Richard J. Sennott and Joan Sennott is wholly without merit and prays that the Petition be denied.

## QUESTION PRESENTED.

As is too frequently the case, zeal has overwhelmed candor in the presentation of the questions presented in the Petition. The Court of Appeals simply did *not* deny that a securities firm was liable for fraud in the sale of securities perpetrated by its representatives; still less did the Court of Appeals excuse the liability of an aider and abetter of fraud or of a "controlling person" because of lack of actual knowledge of the fraud.

Fairly put the question presented is:

> May a sophisticated investor deal with a third party with notice and knowledge that, in the transactions complained of, the third party is acting for his *own* purposes and interests and *not* those of the claimed principal, collude with that third party to hide the facts of fraud from the supposed principal, and recover against the principal because of the fraud under the principles of agency or the liability provisions of the federal securities acts?

## STATEMENT OF THE CASE.

The case involves a distinction to be drawn between legitimate and normal transactions between Petitioners, Richard J. Sennott and Joan Sennott (Sennott) and Respondent, Rodman & Renshaw (Rodman), and a series of subsequent fraudulent transactions between Sennott and one Jordan Rothbart (Jordan). Jordan, during a part of 1957 and early 1958, had been employed by Rodman. That employment ceased in early 1958 (App. 15). In 1960 he became an individual member of the Board of Trade, not connected with Rodman. The fraudulent transactions did not involve Rodman and were conducted *solely* between Sennott and Jordan, individually.

The facts set forth by the Court of Appeals reflect a pattern of proper and legitimate trading, on behalf of Sennott, through William Rothbart, Jordan's father, and Rodman. These trades were suggested by Jordan and forwarded by him to his father. The trades were normal in every respect; payments were made to Rodman by Sennott; confirmation slips were issued by Rodman to Sennott; brokerage fees were paid by Sennott to Rodman.

By contrast, Sennott's dealings with reference to the transactions upon which suit was brought, the sales by Jordan to Sennott of non-existent stock options, were entirely with and between Sennott and Jordan. As found by the trial court:

> "* * * Jordan Rothbart said that *he* was willing to exercise some of the options on behalf of Sennott. Jordan Rothbart also told Sennott that *he* was going to exercise some of the options for *himself* and that all the money for the options would be held in escrow in New York City until the time came for the exercise of the option rights. *He* told Sennott that the options would be exercised for shares of Skyline Homes, Inc. stock within seven months and that *he* would then deliver shares of stock to Sennott at a price of $26.50 per share." (App. 4). (Emphasis supplied).

Jordan had further represented to Sennott that the non-existent stock options had been offered to Jordan's father but that his father had been forced to turn them down because SEC regulations forbade such transactions.[1] Jordan reached agreement with Sennott that neither would divulge the nature of their dealings. Sennott understood by this stricture of confidentiality that he would not say anything about the transactions to anybody, including Jordan's father (App. 23). Sennott's payments were recorded only by handwritten receipts, prepared by Sennott and signed by Jordan (App. 18), and by cancelled checks, payable only to Jordan, deposited in Jordan's wife's account and then returned to Sennott.

On seven separate occasions between March 18 and October 2, 1964, Sennott advanced to Jordan a total of $132,000.00 on the purchases involved in this appeal. In November, 1964, *after* the promised date of delivery of the stock had come and gone, and all payment had been made by Sennott to Jordan, Sennott was invited to meet with Rodman's managing partner, Vernon Carroll, to discuss some checks (App. 4) drawn by Rodman and endorsed by Sennott to Jordan. It is only in connection with this meeting *after* Sennott had completed his "investment", that Sennott sought to assert some connection of Rodman with the transactions in issue.

1. Whether or not such transactions were licit, the effect of the representation was to exclude the father and Respondent from participation in the "options", another indication that Sennott knew he was dealing solely with Jordan individually.

Jordan's father, William Rothbart, requested that Sennott not cooperate with Mr. Carroll and told Sennott that if he did not cooperate, Sennott would get the Skyline stock from Jordan (App. 4).[2] Sennott attended the meeting and twice told Mr. Carroll that the checks were none of his (Rodman's) business (App. 19). Later, Sennott and his wife executed letters exonerating Rodman from liability for failure to investigate the checks.

Sennott pressed Jordan (not Rodman) for delivery of his shares of Skyline and received stock worth, at the time, $82,600.00 in six installments from February 26, 1965 to January 20, 1966. This stock was purchased by Jordan (not through Rodman) and transferred to Sennott by Jordan (App. 19).

It was not until June, 1966, after vain attempts to obtain further delivery of the promised shares from Jordan, that Sennott brought the matter up with Rodman (App. 20, 21). Sennott testified his understanding was that the option shares were not coming from Rodman but through Skyline *and he denied, under oath, that William Rothbart participated or conspired with Jordan to perpetrate the fraud (App. 23).*

## THE COURT DECISIONS.

The reasons advanced for granting the writ are completely spurious. Petitioners ascribe to the Court of Appeals a requirement of "actual prior knowledge" of fraud before a broker-dealer could be liable (Petn. p. 11). The Court of Appeals has not so held.

The District Court found liability against Rodman upon the factual premise that William Rothbart had knowledge of his son's perfidy and imputed that knowledge to Rodman. The Court of Appeals rightfully held that the District Court's find-

2. In their Petition, page 9, Sennott represents that the District Court found that this statement was made in order to protect the profitable legitimate business. No such finding was made.

ings in that respect were not supported by substantial evidence. The Petition does not challenge the Court of Appeals' holding in this respect:

> "Having reviewed the record at length and found that the evidence supports neither plaintiff's theory that William Rothbart had knowledge of his son's reprehensible scheme which was imputed to Rodman nor their theory of apparent authority, we are forced to reject the trial court's factual findings and legal conclusions with reference to these issues." (App. 25).

And,

> "* * * [W]e find no reason to believe that Sennott considered William Rothbart to be any part of the transaction other than that he had been the original offeree of the mythical options." (App. 23).

With reference to Jordan's supposed "agency" in the fraudulent transactions, the Court of Appeals emphasized that the transactions had nothing to do with Rodman and that Sennott knew this:

> "* * * [N]ot only did the fraudulent representations never involve Rodman but both Sennott and Jordan actively sought to prevent Rodman from discovering the option transactions. Sennott agreed to keep the option plan secret, including from Rodman, and intentionally used personal payment receipts to record Sennott's payments. The strongest evidence of the plaintiffs' lack of reliance upon Rodman, however, is seen in Sennott's refusal to cooperate with Carroll's inquiry into the endorsements on Sennott's checks. Had Sennott been relying on Rodman's participation in the option plan, it is unlikely that he would have refused even to discuss the matter with a representative of Rodman. On the contrary, Sennott's own statements belie such reliance. Responding to an inquiry by defendant's attorney, Sennott observed, '[W]ith regard to this money that had been invested, I really felt that this thing would have completely gone undetected by Rodman & Renshaw had not that check been made out of the profit sharing.'" (App. 24).

The Court of Appeals further found:

> "Simply stated, the damage Jordan Rothbart inflicted upon the plaintiffs was a result of Sennott's misplaced reliance upon Jordan Rothbart and not upon Rodman & Renshaw." (App. 25).
>
> * * * * *
>
> "Without a showing that a Rodman partner or agent had knowledge of the fraudulent acts, and in the absence of a showing that here Jordan was purporting to act for Rodman, there is no basis for holding Rodman liable for acts of third parties." (App. 25).

This case involves then, the extent of liability of a brokerage house for the actions of a putative agent where the claimant knowingly deals with him on his own account.

## REASONS FOR DENYING THE WRIT.

The Petition reflects a misleading analysis of the instant case. It is grounded solely on the inapplicable principle proposed by Petitioners that a broker-dealer should be responsible in damages to an investor defrauded by an employee acting within the scope of his employment, where the investor has relied primarily on the integrity, reputation and responsibility of the broker-dealer.

Illustrative is the reason ascribed for granting the writ (Petn. p. 11) wherein the Petitioners assert that it is of importance to determine the scope of the liability of a broker-dealer under the federal securities laws for fraudulent stock transactions *by persons who are soliciting stock trading business on its behalf.*

The foregoing is not descriptive of the facts of the instant case. The *ratio decidendi* of the Court of Appeals involved the application of well defined principles of law to the particular facts of the case. The Court of Appeals has simply held that Respondent was not liable, either on agency principles or by virtue of the federal securities laws, for the fraud of one

not acting within the scope of any employment when Petitioners knew that he was acting on his own behalf.

The Court of Appeals did not decide any important question of federal law which has not been, but should be settled by this Court; nor did that Court decide any question of federal law in a way which departs from the announced policies of Congress and this Court and from decisions of other federal courts.

I.

**Rodman Is Not Liable for the Actions of Jordan Acting on His Own Behalf Where Sennott Dealt with Him with Knowledge That He Was So Acting.**

Petitioner, Richard S. Sennott is an unlikely apostle for the creeds of honesty and full disclosure which he enlists in support of his Petition. The fraudulent scheme perpetrated upon him depended upon his connivance. At the inception of the scheme he agreed to go into the deal with Jordan, accepting as a condition his silence and concurring with the necessity of secrecy.

After his transactions with Jordan were completed, in response to inquiry, Rodman was twice informed by Sennott that his dealings with Jordan were none of Rodman's business. Now, he would have it appear, it was all of Rodman's business.

In reference to the non-existent stock options, the acquisition of the options by Jordan or Sennott could not conceivably benefit Rodman, so it may not be said that Jordan's actions were in the course of any agency on Rodman's behalf; it would be accurate to say that Jordan was then acting in Sennott's behalf and so was their agent or their partner in reference thereto. Here the facts divorce the fraudulent transactions from *any* connection with Rodman. The normal trades with the broker-dealer and the profit realized upon a stock transaction in the same stock (and not options) through the normal transactions do not yield the intricate relationship between the

fraudulent and the legitimate transactions discerned by Petitioners (Petn. p. 13).

Here, *Sennott* was invited by Jordan to participate with *him* in transactions which *he* was told was forbidden Rodman. Here, *Sennott* paid *Jordan* directly. Here, *Sennott* wrote checks to *Jordan* and receipts to be signed by *Jordan* acknowledging payment and promising delivery. Here, *Sennott* sought delivery of the shares from *Jordan*, not from Rodman, and eventually obtained delivery from *Jordan*, but not from Rodman. It would be difficult to imagine a less compelling case for extension of liability in any moral, legal or equitable context. Certainly the commendable purposes of the securities laws do not dictate such a result.

It is submitted that acceptance by this Court of certiorari in *Kamen & Co.* v. *Paul H. Aschkan & Co.*, 382 F. 2d 689 (9 Cir. 1967), cert. granted, 390 U. S. 942, cert. dismissed, 393 U. S. 801 (1968) can not be said to be an indication of this Court's disapproval of that opinion. In any event, the present case is an inadequate vehicle for examination of the principles there espoused.[3] In *Kamen*, the trial court and the Court of Appeals both had found that, in the transactions complained of, the perpetrators of the scheme were agents of the broker firm who carried out the fraud as an object of, and in, the scope of their employment. Given these facts, concern with reference to the relation of common law agency principles to the liability there involved or the "controlling person" concepts of the securities laws was natural.

The lengthy quotation (Petn. pp. 14, 15) from the Securites and Exchange Commission brief in *Kamen* reflects that concern.

3. In their brief to the Court of Appeals, Petitioners pointed out that *Kamen* was *not* in point since liability was denied because plaintiff there "(1) should have inquired further about the representations made to him and (2) knew the submitted proposition was illegal."

Petitioners rely (Petition pp. 14-15), apparently, more on the Commission's brief than they do on the case itself. The quoted excerpts however emphasize the Commission's focus on the responsibility of broker-dealers "to persons whom their employees have defrauded *in connection with their employment.*" (Italics supplied). The Commission's view was also that a violation "*within the scope of their employment* is necessarily a violation by the firm * * *." (Italics supplied). The Commission was not addressing itself to activities unconnected with or outside of the scope of employment.

Here, where the fraudulent dealings were completely outside of the scope of any putative employment, no purpose or policy of the securities laws is denied by the opinion of the Court of Appeals.

At pages 16 through 20 of the Petition, various aspects of agency law are urged as governing. Sennott, a trader on the fast moving Chicago Board of Trade grain market, analogizes his position with that of the inexperienced, elderly widow in *Blackburn* v. *Witter*, 201 Cal. App. 2d 518, 19 Cal. Repts. 842 (5th Dist. Ct. App. 1962), so described on p. 845 of 19 Cal. Repts.

There, the widow was told that the note sold was coming from the "research division" of the defendant; the individual receipts were explained by a statement that the "new receipts or new documents had not been presented"; and she was told the culpable agent was "the trustee" and was acting for the defendant firm. In short, part and parcel of the fraud were misrepresentations as to the complicity of the brokerage firm upon which the plaintiff in *Blackburn* relied. These facts were asserted against the statutory and common law requirement that the plaintiff act with ordinary care in the transaction.

The facts of the present case caused the Court of Appeals (App. 25) to conclude its discussion of *Blackburn* with this statement:

> "Simply stated, the damage Jordan Rothbart inflicted upon the plaintiffs was a result of Sennott's misplaced reliance upon Jordan Rothbart and not upon Rodman & Renshaw."

Chief Judge Swygert of the Seventh Circuit Court of Appeals was a member of the panel deciding the instant case. Judge Swygert was also the author of the opinion in *SEC* v. *First Securities Co. of Chicago*, 463 F. 2d 981, cert. denied, 409 U. S. 880 (1972) relied upon by Petitioners. *First Securities* was thoroughly briefed and argued in the petition for rehearing in the instant case. It would appear that Judge Swygert detected none of the inconsistencies between the two cases perceived by Petitioners. The present case falls squarely within the ambit of Section 262 of the Restatement of Agency, Second (1958). While Section 261 was central to the *Blackburn* case, Judge Swygert, in *First Securities*, page 985, quoted Section 262:

> "A person who otherwise would be liable to another for the misrepresentations of one apparently acting for him is not relieved from liability by the fact that the servant or other agent acts entirely for his own purposes, *unless the other has notice of this.*" (Emphasis supplied).

The present situation is the converse of this rule. Rodman is not liable for *Jordan's* actions where, as here, *he acted for his own purposes* and Sennott had *notice and knowledge* that he was so acting. Further, the Restatement comments on § 262 emphasize:

> "[P]ersons dealing with agents should be able to rely upon apparently true statements by agents *who are purporting to act and are apparently acting* in the interests of the principal." (Emphasis supplied.)

Here Jordan actually acted *solely* in his own interests, and Sennott was fully cognizant of this fact. The common law doctrines referred to and relied upon at pages 18 and 19 of the Petition amount to no more than a realistic judicial reaction to defensive claims that a principal did not authorize fraudulent

conduct or statements. Where, in fact, Sennott intended to and did deal with Jordan individually, and not with Rodman, the cases and the principles espoused therein furnish no foundation for recovery here.

## II.

### The Court of Appeals Did Not "Require" Knowledge of Fraudulent Acts.

The basis for the trial court's judgment against Rodman was its conclusion that William Rothbart, Jordan's father "knowingly assisted and participated" in his son's fraud and that Rodman "knew or should have known" of the conduct (App. 21).

The Court of Appeals properly found, applying the "substantial evidence" rule, that the finding was in error. The Petition does not challenge that aspect of the Court of Appeals' decision. It is patently unfair and misleading for Petitioners to urge as they do (Petn. p. 20) that the Court of Appeals has "required" knowledge.

The Court of Appeals correctly assessed the record:

> "We are at a loss as to the basis in the record for the district court's conclusion that William Rothbart 'knowingly assisted and participated' in the fraud. Indeed, the first contact the plaintiff had with William respecting the options took place in November 1964, after all of the payments for the stock had been made. This is not a pertinent time. There is no evidence that prior to the Carroll meeting William Rothbart did anything to induce Sennott to subject himself to Jordan's defalcations, nor that he had any knowledge of what was transpiring until after the fact." (A. 22).
>
> "Further, we find no reason to believe that Sennott considered William Rothbart to be any part of the transaction other than that he had been the original offeree of the mythical options. In fact, Sennott himself indicated that his understanding of Jordan's stricture of confidentiality to be he should not say a word about the transaction to

> anybody including William Rothbart. Sennott also testified that it was never his understanding that the option shares were coming from or through Rodman but he imagined they would be coming from the Skyline corporation itself. Finally, Sennott admitted on cross-examination that he had testified in his deposition that when asked by investigators to the Illinois Securities Commission, which was looking into his complaint against Jordan, whether William Rothbart had ever participated or conspired with Jordan to perpetrate the option fraud, he had replied, '[N]o, not to my knowledge.'" (A. 23).

The Court of Appeals held (A. 25) in discussing Rodman's liability for "aiding and abetting":

> "Without a showing that a Rodman partner or agent had knowledge of the fraudulent acts, and in the absence of a showing that here Jordan was purporting to act for Rodman, there is no basis for holding Rodman liable for acts of third parties."

The argument advanced by Petitioners with reference to "aiding and abetting" Jordan's option scheme ignores the peculiar circumstances of the case.[4]

Without knowledge and, emphatically, where Sennott's *own* conduct prevented knowledge, Rodman may not be charged with the purposeful conduct implicit in the phrase "aiding and abetting".

The conduct described (Petn. p. 21) as "aiding and abetting" simply has no relation to the fraud; the placing of the *legitimate* orders was not the precursor for the deception in the sense that "without such transactions, the fraud would not have taken place" as claimed by Petitioners, but was simply prior in time.

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4. In contrast with their present position, Petitioners, in their brief in the Court of Appeals with reference to "aiding and abetting" adopted this position:

> "Where there is knowledge of wrongdoing and a duty to speak, a finding of aiding and abetting a violation of Rule 10(6)-5 may be based on inaction and silence."

The cases cited do not support Petitioners. Petitioners seek to rely upon principles and analogies from factually inapposite decisions. *SEC* v. *First Securities Co. of Chicago*, 463 F. 2d 981 (7th Cir.), cert. denied, 409 U. S. 880 (1972), permitted recovery only upon facts directly implicating the corporation in the fraud involved with none of the facts here present. *Buttery* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 410 F. 2d 135 (7th Cir.), cert. denied, 396 U. S. 838 (1969) and *Anderson* v. *Frances I. DuPont & Co.*, 291 F. Supp. 705 (D. Minn. 1968) are cited for the self-evident proposition that brokerage firms may be liable as aiders and abetters of parties or entities other than themselves. Respondent has no quarrel with either decision; neither applies to the present facts.

## III.

### The Court of Appeals Correctly Construed and Applied Section 20(a) of the Securities Exchange Act of 1934.

The third point of reliance again cites a broad rule of liability, Section 20(a) of the Securities Exchange Act of 1934, without reference to the particulars of this case. Rodman, not possessing knowledge of Jordan's conduct, is not vulnerable to a charge of "bad faith" under Section 20(a). Knowledge was *not*, as stated in the Petition (p. 22), "required as a precondition of liability".

The Court of Appeals did hold that Rodman's "good" or "bad" faith was not pertinent "where Rodman was *admittedly not considered* to be involved in the transaction." (App. 26) (Emphasis supplied). The Court went on:

> "Rodman's duty to control its partners and agents, as well as its past employees, in situations such as this extends only to transactions with or by these parties where Rodman is itself involved. To extend it further would be to impose liability upon Rodman for virtually any act of its past or present employees and partners regardless of how remote and unrelated that act might be to Rodman & Renshaw. We are not inclined to read Section 78t so expansively."

How a person or entity may be characterized as a "controlling person" with reference to a transaction which literally, figuratively and legally was "none of its business" is not and can not be explicated by Petitioners. Nor may Jordan be deemed a "controlled person" when he was engaged in his own affairs.

The Court did find, "We do not see how Rodman can be found to have exercised bad faith with respect to a transaction of which it had no knowledge" (A. 26). This finding of good faith is not questioned by Petitioners. The quote is from a footnote in the Court's opinion and furnished an additional reason for exculpating Rodman in addition to the unassailable position adopted by the Court as the "duty" to control.

In the context of the present case, the Court's comment is entirely consonant with common sense and the statute. Rodman's good faith may not be assailed with reference to a transaction unrelated to the firm's business where it had no knowledge of the transaction. This together with the Court's further finding that Rodman did not act in bad faith nor induce the transaction (Footnote App. 26) precludes any liability of Rodman under Section 20(a).

## CONCLUSION.

The decision of the Court of Appeals was squarely grounded upon a correct interpretation of the facts before it, facts which are not now the subject of dispute.

The decision neither offends past precedent nor the controlling statutory provisions.

The effect of the decision will be only to deprive a sophisticated investor of a windfall. Apart from that, the decision will have only the salutary effect of eliminating some of the weeds in the litigation garden.

Respectfully submitted,

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